

California Debt and Investment Advisory Commissions

Understanding Municipal Securities Regulations

Good Disclosure: It's in the Process

**A Financial Advisor's Perspective
on Primary Market Disclosure**

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Good Disclosure is an Art, Not a Science

- Minimal written guidance is available.
 - The “Bible”, GFOA’s *Disclosure Guidelines for State and Local Government Securities*, last published in 1991. It is now out of print.
 - NFMA “Recommended Best Practices” are filling the void.
 - GFOA has published “Making Good Disclosure”. Helpful, but far from definitive.
 - Vince & Elkins report for San Diego a good resource, but not the law.
- There is not a “one-size-fits-all” standard.
 - Depends on the transaction, its complexities and risks.
- Good judgment is more important than learning a fixed set of rules.

Some “Idiot Lights” to Pay Attention to in Assessing the Adequacy of Your Official Statement

➤ Issuer dissonance

- Things that you don’t understand.
 - Don’t simply assume that investors know more than you do, especially in the discussion of legal and governmental factors.
- Things that don’t seem quite accurate.
 - The act of “due diligence” includes fact checking.
- Things that might make you look bad.
 - If you think that information might negatively effect an investor’s decision to invest or result in a lower bond rating, and that would be a reasonable reaction...
 - 📁 the information is probably material, and should be included..

More “Idiot Lights” to Pay Attention to in Assessing the Adequacy of Your Official Statement

- Things that you don’t think are relevant.
 - Irrelevant disclosure is in itself misleading.
- Boilerplate
 - Always suspect to me, because often not carefully read by preparers of the document.
- Consistency (or, “one of the things I learned from San Diego”)
 - Does the OS agree with the CAFR?
 - Are there other official documents with conflicting information or messages?

Investor Feedback

- Since most issuers don't actually talk with investors, the rating agencies and bond insurance companies are your best proxy.
- Consider incorporating in your official statement:
 - Information that you have provided to the rating agencies and insurance companies that is not in your O.S.
 - Projections
 - Details on assumptions
 - Financial information that is more current than your last audit
 - Preliminary debt service numbers
 - The answers to (relevant) rating agency questions.
 - The answers to (relevant) insurance analyst questions.
 - Facts or observations included in a rating agency credit report that weren't included in your O.S.

Thoughts on Audits

- Include portions that are relevant to the issue at hand. The summary financials and its notes are not always sufficient.
 - Examples of additional material
 - MD&A (Management Discussion and Analysis).
 - For revenue bonds, include the enterprise fund section.
 - May be a growing trend to include the whole CAFR
 - Sobering fact: the risks relating to pre-bankruptcy Orange County were in the fiduciary funds section of the audit (and who reads *that?*)
- Should the auditor's consent be reinstituted to help protect the issuer?

More Thoughts on Audits

- Audits are never fully satisfying to the experienced analyst
- Good disclosure supplements the audit. Some examples.
 - More information on the types of “tax” revenues (audits often consolidate property tax, sales tax and other taxes into a single “taxes” line item).
 - “Intergovernmental revenues” usually include motor vehicle license fees or public safety sales tax revenues, which are general fund or quasi general fund revenues.
 - Information on transfers in and out.
 - Translating between budget (the language of managers) and GAAP (the language of analysts).

Other Thoughts

- The issuer's lead staff person should not shoulder full responsibility for the accuracy of the official statement.
 - Circulate sections to appropriate peers for review and comment (e.g., the budget officer, the pension manager, etc.).
- Footnote tables freely to illuminate assumptions.
- One of the greatest deficiencies in O.S.'s (in my judgment) is that they discuss minutiae (e.g., two full pages on how one calculates the Gann limit), but omit the basics (e.g., what is this specific issuer's limit and its appropriations subject to the limit, and whether this is an actual area of risk or concern).

Final Observations

- Think of the O.S. less of a sales document and more as your defense if you are ever sued.
 - In a securities action, the O.S. is Exhibit 1. Think about what you wish it would have said.
- Like all processes of self-knowledge, it is never done.
 - I have never seen a perfect O.S. Always room for improvement.
- The San Diego crisis will have lasting impact.
 - Disclosure will almost certainly be more expensive.
 - Disclosure may or may not be better.